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FISCAL IMPACT STATEMENT

LS 6806 | **NOTE PREPARED:** Dec 22, 2004
BILL NUMBER: HB 1669 | **BILL AMENDED:**

SUBJECT: Enterprise Zone Incentives.

FIRST AUTHOR: Rep. Hinkle | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL | **IMPACT:** State
X DEDICATED
FEDERAL

Summary of Legislation: This bill increases the amount of the Enterprise Zone Loan Interest Credit from 5% to 15% of the interest received from qualified loans. The bill allows a taxpayer to assign the Enterprise Zone Investment Cost Credit and provides that trusts, estates, corporations, and pass through entities that make qualified investments in enterprise zone businesses may claim the Enterprise Zone Investment Cost Credit. (Current law allows only individuals to claim the credit, except in Vigo County where pass through entities are also eligible.) This bill also establishes the Enterprise Zone Job Creation Tax Credit.

Effective Date: January 1, 2000 (retroactive); January 1, 2006.

Summary of Net State Impact: The bill could potentially reduce revenue from the Adjusted Gross Income (AGI) Tax, the Financial Institutions Tax (FIT), and the Insurance Premiums Tax by about $4.4 M in FY 2007. However, the fiscal impact could begin in FY 2006 if taxpayers adjust their quarterly estimated payments.

Explanation of State Expenditures: The Department of State Revenue (DOR) would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the new credit and changes to existing tax credits. These expenses presumably could be absorbed given the DOR's existing budget and resources.

Explanation of State Revenues: *EZ Loan Interest Credit:* It is estimated that increasing the Loan Interest Credit from 5% to 15% of interest received could potentially reduce state revenue by about $2.0 M annually beginning in FY 2007. The revenue loss could begin in FY 2006 if taxpayers adjust their quarterly estimated payments.

EZ Investment Cost Credit (ICC): The bill extends the ICC to corporations and pass through entities, and allows a taxpayer entitled to the ICC to assign the credit to another taxpayer. These changes are effective beginning in tax year 2006. The fiscal impact of these changes is indeterminable.

EZ Job Creation Tax Credit: It is estimated that the Job Creation Tax Credit could potentially reduce state revenue by about $2.4 M in FY 2007. The revenue loss could begin in FY 2006 if taxpayers adjust their quarterly estimated payments. It is estimated that the revenue loss could potentially grow by about 1.4% annually thereafter.

State Enterprise Zone Board: One percent of the incentive dollars obtained by taxpayers claiming EZ tax incentives could potentially flow to the State Enterprise Zone (EZ) Board through its EZ business registration fee. Businesses receiving EZ incentives must pay a fee equal to 1% of the incentives obtained by the business if the incentives exceed $1,000 during the year. The 1% fee in connection with: (1) the increase in the EZ Loan Interest Credit would generate about $20,000 annually (1% of $2.0 M in additional annual credits); and (2) the EZ Job Creation Tax Credit would generate about $24,000 annually (1% of $2.4 M in annual credits).

Background Information: EZ Investment Cost Credit (ICC) - Under current statute, the ICC may be claimed against the Adjusted Gross Income (AGI) Tax by individuals purchasing an ownership interest (an equity investment) in an EZ business. Current statute allows pass through entities investing in businesses in a Vigo County EZ to claim the ICC. The ICC is equal to a maximum of 30% of the equity investment. The credit percentage allowed (up to 30%) varies depending upon the type of investment, the type of business, and the number of jobs created. The credit is nonrefundable, but a taxpayer may carry over excess credits to subsequent taxable years.

The bill extends the ICC to corporations and pass through entities effective beginning in tax year 2006. The bill also allows a taxpayer who is entitled to claim the ICC to assign any portion of the credit to another taxpayer. The bill requires the taxpayer assigning the ICC to contribute 14% of the proceeds of the assignment to the Urban Enterprise Association for the EZ in which the taxpayer is located; and to reinvest the remaining proceeds in the taxpayer's EZ operations. Over the years $2.9 M in credits have been approved. However, data is unavailable indicating the amount of the approved credit total that has been claimed by taxpayers against their tax liabilities.

With respect to credits that have already been certified but remain unused, the change allowing assignment of the ICC has no long-run fiscal impact. Assuming that currently unused credit amounts would eventually be utilized, allowing assignment of the ICC simply provides for more timely use of these outstanding credits already obtained by taxpayers. Both changes, however, could potentially increase the certification of new credits in future years. Since data describing the investment behavior of EZ businesses is unavailable, the fiscal impact of new credit activity is indeterminable. The revenue impact depends on the extent to which the changes to the ICC encourage future equity investment in EZ businesses. Credits for investment encouraged by the ICC or the changes made by this bill presumably are not a revenue loss to the state. However, if the investment would have occurred in the absence of the ICC or the changes made by this bill, the net impact would be the total credits claimed by investors.

EZ Loan Interest Credit (LIC) - The LIC is a nonrefundable tax credit that a taxpayer may claim against the AGI Tax, the Financial Institutions Tax, or the Insurance Premiums Tax. The credit is equal to 5% of the interest a taxpayer receives during the taxable year on qualified loans to businesses or individuals for specified uses in an EZ.

The bill triples the EZ Loan Interest Credit (LIC) from 5% to 15% effective beginning in tax year 2006. The increase would apply to interest received from outstanding loans as well as new loans. Effectively, the net revenue impact of tripling the tax credit depends on the extent that collections on taxable activities attributable to the creditable investment or improvements within the EZs is less than or exceeds the additional tax credits claimed. However, if the investment or improvements would have occurred in the absence of the increased tax credits, the net impact would be the total of the additional credits claimed by taxpayers. Future credits attributable to loans encouraged solely by the increase in the LIC is indeterminable. However, the fiscal impact from (1) outstanding loans and (2) new loan activity that would have occurred without the increase in the LIC is estimated to be approximately $2.0 M annually. The 5% LIC has averaged about $1.0 M annually in recent years. The estimated revenue loss assumes that the level of new loan activity encouraged by the current 5% credit would remain a constant in future years. This new activity would serve to replace outstanding loans being paid off such that a 5% LIC would result in roughly $1.0 M in credits being claimed per year in the future. Thus, increasing the LIC to 15% is estimated to generate an annual revenue loss that would otherwise not occur. This revenue loss is estimated to total about $2.0 M.

EZ Job Creation Tax Credit - The bill establishes the EZ Job Creation Tax Credit as a nonrefundable tax credit equal to $2,000 for each new employee employed by a taxpayer at an EZ location during the taxable year. The credit is effective beginning in tax year 2006. The credit could be claimed against the taxpayer's Adjusted Gross Income (AGI) Tax, Financial Institutions Tax (FIT), or Insurance Premiums Tax liability. Under the bill, a new employee is an employee first employed by the taxpayer at the EZ location during the taxable year. It does not include an employee in a position previously held by another employee or an employee previously employed elsewhere in Indiana by another person or entity having a business relationship with the taxpayer. The credit is nonrefundable, but any unused credit may be carried forward to subsequent years. The tax credit may not be carried back to previous years.

The net revenue impact of this credit depends on the extent that tax collections from new employees are less than or exceed the amount of credits claimed by the business. However, if the employees would have been hired in the absence of the tax credit, the net impact would be the total credits claimed by the business. It is estimated that the one-time $2,000 tax credit could potentially encourage 60 new EZ jobs per year. This is based on: (1) estimates of the average percentage increase in demand for labor given a 1% reduction in the average wage; and (2) current employment and average wage levels within the EZs. The credits claimed for these jobs would total approximately $120,000 annually. However, the revenue loss from employment growth that would have occurred without the $2,000 tax credit is estimated to total about $2.3 M in FY 2007, and could grow annually thereafter by about 1.4%. This estimate is based on: (1) long-run employment growth in cities containing EZs for the period 1990-1999 and 1990-2003; and (2) current employment within the EZs.

Revenue from the AGI Tax on corporations, the Financial Institutions Tax, and the Insurance Premiums Tax is distributed to the state General Fund. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of the revenue is deposited in the Property Tax Replacement Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: Department of State Revenue, Indiana Department of Commerce, State Enterprise Zone Board.

Local Agencies Affected:

Information Sources: Department of Commerce, Enterprise Zone Business Registration data. LSA Enterprise Zone Database. Bureau of Labor Statistics, *Local Area Unemployment Statistics* database - 1990-2003. Sarah Lowe, *Indiana Enterprise Zone Program: Employment and Fiscal Impact Analysis of a Job Creation Tax Credit*, Thesis, Purdue University, 2004. Kim Clark & Richard Freeman, "How Elastic is the Demand for Labor? *The Review of Economics and Statistics*, 1980.

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